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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Inter-Carrier Compensation for ISP-Bound Traffic	)	CC Docket No. 99-68
	)	

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REPLY COMMENTS OF BELL ATLANTIC ON NOTICE OF PROPOSED RULEMAKING

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I. Introduction

It should come as no surprise that the very carriers who have been gaming the regulatory process to extract huge sums for calls to the Internet argue vigorously to retain the current uneconomic levels of compensation. These carriers are making hundreds of millions of dollars from that compensation. The bulk of the payments go to only two giant companies – AT&T and MCI WorldCom. In addition, other so-called "carriers" that have sprung up act primarily as fronts for Internet service providers ("ISPs") and owe their entire existence to these payments. In fact, this cash flow is so great that many of these carriers are splitting the cash by paying kickbacks to ISPs that sign up for their service. It is no wonder that they are willing to pull out all the stops to keep the gravy train on the tracks. But this gravy train has created an enormous deterrent

[1] The Bell Atlantic companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

to local competition and must be derailed in order to provide all parties with incentives to negotiate an economically rational result.

Instead of retaining the present uneconomic payment system, the Commission should, as most parties urge, encourage use of negotiations to determine whether inter-carrier compensation should be paid on calls to the Internet and if so, at what level. If negotiations are unsuccessful, voluntary alternative dispute resolution mechanisms should be relied upon. As a backstop, the Commission should prescribe a neutral mechanism that allows each carrier to retain the payment it receives from its own customer. Thus, the originating carrier would receive payment from its end user, while the interconnecting provider's compensation would come from the ISP. Adopting this proposal would place all carriers in precisely the same position, promote investment in competing local facilities, and provide all carriers with an incentive to enter into economically rational arrangements for handling traffic bound for the Internet.

II. The Present System of Payments For Calls to the Internet Should Be Eliminated.

There is no justification whatsoever for retaining the present system of regulatorily-mandated uneconomic payments to carriers that hand off Internet traffic to ISPs. These windfall payments provide no benefit to the public. Instead, they dramatically increase the cost of serving residential and small business customers who use dial-up access to the Internet. And they deter local competition. Indeed, if competing carriers were to sign up these customers for their own local services, they would not only lose their existing flow of cash, but may end up subsidizing other carriers that deliver the traffic to the ISPs. As a result, these carriers are more than content to receive "reciprocal compensation" from incumbent carriers that totals hundreds of millions of dollars, or, by one independent analyst's estimate, well over a billion dollars by next year.[2] In addition, the payment scheme retards innovation, because it provides a disincentive for carriers – and their ISP customers – to adopt new technologies for Internet calling which would not give them their windfall payments.

a. *The Current Payment Scheme Retards Competition and Innovation.*

As fifteen public interest groups accurately point out, the inter-carrier compensation payments "represent revenues that are not going into new product development, infrastructure investments, deployment of advanced services in rural and inner city areas, new telecommunications services and products for persons with disabilities, and other benefits to the telecommunications consumer," Keep America Connected et al. at 9-10. Instead, the "drain of revenues" that gives unjustified windfall profits to the shareholders of some carriers "undermines competition in residential, inner city and rural markets and discourages investments in advanced telecommunications services." *Id.* at 10. As these organizations succinctly demonstrate, the current inter-carrier payments provide no public interest benefit.

b. *Present Compensation Levels Are Unrelated To Cost.*

The record clearly demonstrates that the size of the current payments are wholly unrelated to the cost of the functions that the carriers perform in handing off

[2] "Telecom Services – Local: The Mysterious World of ISP-Related Reciprocal Compensation," In-depth Report, Merrill Lynch & Co., Global Securities Research & Economics Group, at 11 (Oct. 27, 1998) (cited in GTE at 9).

Internet traffic to ISPs. It is for this reason that the carriers who receive the windfall continue to demand inter-carrier payments based upon the incumbents' costs to deliver true local traffic rather than their own costs to deliver Internet calls to the ISPs. *See, e.g.* MCI WorldCom at 15-16, AT&T at 10-11, ALTS at 14-19. The reciprocal compensation rates set by state commissions for the exchange of true local traffic, however, are based upon an assumed use of two switches, including a tandem switch, and extensive trunking.[3] The carriers that deliver traffic to the ISPs use, at most, a single switch and often little or no transport facilities. This is because their facilities are typically collocated with the ISP they serve. Even if some transport is needed, it generally uses high-capacity trunks to deliver large volumes of traffic to a single ISP at a low unit cost. And the transport to get the Internet-bound calls to the ISP's carrier is paid for not by that carrier, as it should be, but by the originating incumbent carrier. This, in effect, provides the ISP's carrier with a free LATA-wide transport system.

As the record shows, in some instances, these carriers perform no switching functions at all but merely hand off the traffic to the ISP. This is because current technology allows the carriers to use SS7 bypass devices to deliver calls directly to ISPs without any circuit switching.[4]

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[3] The Commission's rules require that reciprocal compensation payments for true local service be "symmetrical," so that interconnecting carriers receive payments based upon the incumbent's costs. *See* 47 C.F.R. § 51.711(a). In a great many cases, the incumbent's costs are determined based upon the cost of tandem interconnection, whether or not tandem switching is actually being used. *See* 47 C.F.R. § 51.711(a)(3).

[4] *See ISPs Strongarm GTE; UUNet, Others Demand SS7 Bypass Savings*, ISP Business News at 1 (Nov. 9, 1998) (cited in GTE at 7).

In addition, there is significant evidence that these payments vastly overcompensate carriers for the costs of handing off Internet traffic to the ISPs. The best indication is those carriers' willingness to share their payments by providing kick-backs to their ISP customers. Information obtained from the Internet and other published sources show that such practices are wide-spread. For example, in an exchange appearing on the Internet discussion group *isp-clec.com* in November 1998, a customer of ACC (now owned by AT&T) responded to a question about receiving free ISDN PRI circuits from that carrier by writing:

> Around here the way this works is you pay for the PRIs and get back a percentage of the recip payments, enough so a PRI is 'free' if you keep it very busy. When recips go away, you're back to normal, ISP paying for service and CLEC making money selling it.

Similarly, a note appearing on another Internet newsgroup, *info.inet.access*, on October 25, 1998 indicated that

> Bell Atlantic pays at least some of the CLECs .008 per minute. We are talking to a CLEC now that is offering us .002 of that plus free PRIs if we have a certain traffic level.

Likewise, a Buffalo newspaper article pointed out that an ISP that uses ACC and Hyperion "receives a fraction of termination fees paid by Bell Atlantic under network interconnection deals with those companies."[5] A vice president of the ISP is quoted in the article as saying "[e]very single ISP . . . in Buffalo is on this deal." On another newsgroup, *lists.robotics.net*, a posting revealed that TCG "went after the ISP business

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[5] David Troester, "Local phone companies are dialing into pot of gold," *Business First*, November 16, 1998 (available at http://www.amcity.com/buffalo/stories/1998/11/16/story4.html).

bigtime and signed up every single ISP based in BA territory in this LATA. . . . and they give me a cut of the recips to boot."[6] These examples show that at least some of the carriers that serve ISPs, including current affiliates of AT&T (ACC and TCG) are using some of the excess cash they receive from the incumbents for carrying Internet traffic to provide kick-backs to their ISP customers.

c. *Originating Calls to the Internet Are Under Water Even Without Inter-Carrier Compensation.*

The carriers that receive these windfalls are also wrong in their claim that these payments amount to an appropriate sharing of revenues by the incumbents with carriers that carry the Internet traffic to the ISP. As the comments here abundantly show, originating carriers typically lose money on Internet traffic even <u>before</u> payment of inter-carrier compensation. Ameritech at 8-14 and Att. A. *See also* Cincinnati Bell at 5 ("The network costs incurred by the originating LEC are not recovered from anyone or anywhere"), GTE at 6 ("ILECs are expected to make these payments out of funds that do[] not exist"), US WEST at 7 ("the much-longer-than-average holding times for ISP-bound dial-up calls impose significant costs on the LECs serving the ISP subscribers, even if the calls are handed off to another LEC who actually hands them to the ISP"), NTCA at 5 ("additional switching and trunking capacity is required, as well as the need for loop plant").

[6] Not surprisingly, many of these so-called "carriers" provide little or no local service to end users. In its initial comments, Bell Atlantic (at 3, n.2) pointed out that Level 3 Communications and Global NAPs, Inc., have stated in public filings that nearly all of their revenues have come from reciprocal compensation payments. GTE (at 9) showed that US LEC also estimated publicly that it received two-thirds of its 1998 revenues from reciprocal compensation payments.

In any event, when the payment that an incumbent makes to its competitor exceeds the total revenue the incumbent receives for the entire line, as the record shows is often the case, there is no way that the payment level can be justified. While this may be due in large part to the ESP exemption, which forces the incumbent to charge local rates rather than access charges for Internet traffic, that exemption does not justify exacerbating the loss by forcing incumbents to give competitors huge windfalls.

Nor are the payments justified by any appreciable cost savings from forgoing the need to provide terminating switching, trunking and other facilities to deliver traffic to the ISPs. Any such savings are substantially offset by the increased transport costs occasioned by the need to build extensive LATA-wide trunking facilities to deliver large quantities of traffic to the ISP's carrier's location – which is often the same location as the ISP.

In contrast, adopting a backstop mechanism that permits each interconnecting carrier to retain the revenues it receives from its own customer will place each carrier in precisely the same position as the other, preserve incentives to provide competing local services, and provide both carriers with incentives to negotiate economically rational arrangements.

III. Calls to the Internet Are Not Local Traffic, and Sections 251 and 252 Do Not Apply

A number of competitors continue to argue that the Commission should simply apply to non-local calls to the Internet the same reciprocal compensation rate that was adopted in interconnection agreements for two-way local traffic. They also ask the

Commission to permit state regulators to force carriers in future arbitration proceedings to pay compensation on Internet calls. It should not and legally may not.

As the Commission properly found in this very proceeding, calls to the Internet are not local calls. *See Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68*, FCC 99-38, ¶ 18 (rel. Feb. 26, 1999).[7] And, as the Commission earlier found, the statutory reciprocal compensation provisions apply only to local traffic. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, ¶ 1034 (1996). Therefore, the local competition sections of the Act, and in particular the reciprocal compensation provision (section 251(b)(5)), is inapplicable. As a result, the local competition provisions of the Act, sections 251 and 252, including the reciprocal compensation and "most favored nation" provisions, are simply not pertinent to compensation for calls to the Internet.[8]

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[7] The Commission found that "a substantial portion of the Internet traffic involves accessing interstate or foreign websites." *Id.* And, as every party that addressed this issue agreed, it is impossible to segregate interstate and intrastate Internet traffic. Therefore, all the traffic is preemptively in the federal jurisdiction.

[8] ALTS claims (at 7) that section 252(c) permits arbitration of "any open issue" which, it claims, includes compensation for Internet calls. That provision, like all of section 252, applies only to issues addressed in section 251, which in turn applies only to local competition, not interstate calls into the Internet. ALTS also claims (at 20) that Bell Atlantic "has insisted on inserting restrictions" into interconnection agreements relating to reciprocal compensation and refusing to allow other carriers to opt into existing agreements under section 252(i). ALTS is wrong. The only "restrictions" relating to reciprocal compensation are statements that the parties to the agreements disagree as to the application of reciprocal compensation to Internet traffic. As to 252(i), since the Supreme Court decision on the subject, Bell Atlantic allows other carriers to opt into provisions of all agreements, except those that expire within a few months of the request, and requires that the provisions of new agreements expire upon expiration of the agreement after which the provision is modeled.

Time-Warner (at 3-8) makes the spurious claim that calls to the Internet and local service are "like" services for which non-discriminatory reciprocal charges must be imposed under section 202(a) of the Act. Time-Warner is clearly wrong. As the Commission has found, Internet calls are interstate, not local, and are treated in all respects (except for rates) as exchange access traffic. It is therefore not subject to the statutory provisions relating to local traffic. In fact, the only things that are "like" about local and Internet calls are the rates charged for services provided to ISPs, and that is a result of regulatory fiat under the ESP exemption, not the nature of the service itself.

Several parties argue that, instead of deferring to the states, the Commission should prescribe a cost standard that is comparable to the state reciprocal compensation levels, such as TELRIC, or should apply its proxy network element rates to Internet traffic. There is no cost justification for either of these results. The reciprocal compensation rates are generally based on the TELRIC costs of the incumbent carrier when it provides tandem switched interconnection to other local carriers. As discussed above, those costs bear no relationship to the costs of the ISPs' carriers to deliver traffic, which are far lower than the existing reciprocal compensation rates set by state commissions.[9] Rather than compensating the carriers for the lower costs they incur to handle one-way calls to the Internet, use of the incumbents' costs of handling two-way local traffic would simply perpetuate the gravy train.

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[9] As Bell Atlantic pointed out in its opening comments, Global NAPS has stated publicly that the compensation it receives from Bell Atlantic is nearly twelve times its costs of delivering traffic to its ISPs. Bell Atlantic Comments at 3, n.2.

If the Commission recommends any formula for inter-carrier compensation, which it should not, it should decide that any inter-carrier payments should be no more than the direct variable costs that an efficient carrier would incur just to deliver the Internet calls to an ISP. In that way, compensation would be based on the additional out-of-pocket cost that an efficient carrier would incur to pick up traffic and deliver it to the ISP.[10] This standard, which mirrors the one that the Commission applies to incumbents, would avoid the current windfalls and make it uneconomic to provide rebates to the carriers' ISP customers.[11]

In addition, if it adopts any additional rules, the Commission should apply any inter-carrier compensation on Internet traffic only where the carrier receiving that compensation offers to accept calls from the originating carrier within the local calling area of the originating caller. Otherwise, Bell Atlantic will be forced to invest in the additional trunking needed to carry traffic to another carrier's office in a distant calling area. At the very least, the interconnecting carrier, if it does not have a local presence, should compensate the originating carrier for hauling the traffic to the distant location.

[10] This limitation would require the ISPs' carriers to cover their investment costs, overhead, and profit, not with windfall payments for carrying Internet traffic to ISPs, but instead by providing true local exchange service in competition with the incumbents.

[11] Of course, any findings in this proceeding should not apply to voice services which employ Internet Protocol technology.

IV. Conclusion.

Accordingly, the Commission should adopt the policies that Bell Atlantic urged in its initial comments.

Respectfully Submitted,

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April 27, 1999

CERTIFICATE OF SERVICE

I hereby certify that on this 27th day of April, 1999, copies of the foregoing Reply Comments of Bell Atlantic were sent by first class mail, postage prepaid, to the parties on the attached list.

Jennifer L. Hoh

Jennifer L. Hoh

* Via hand delivery.

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